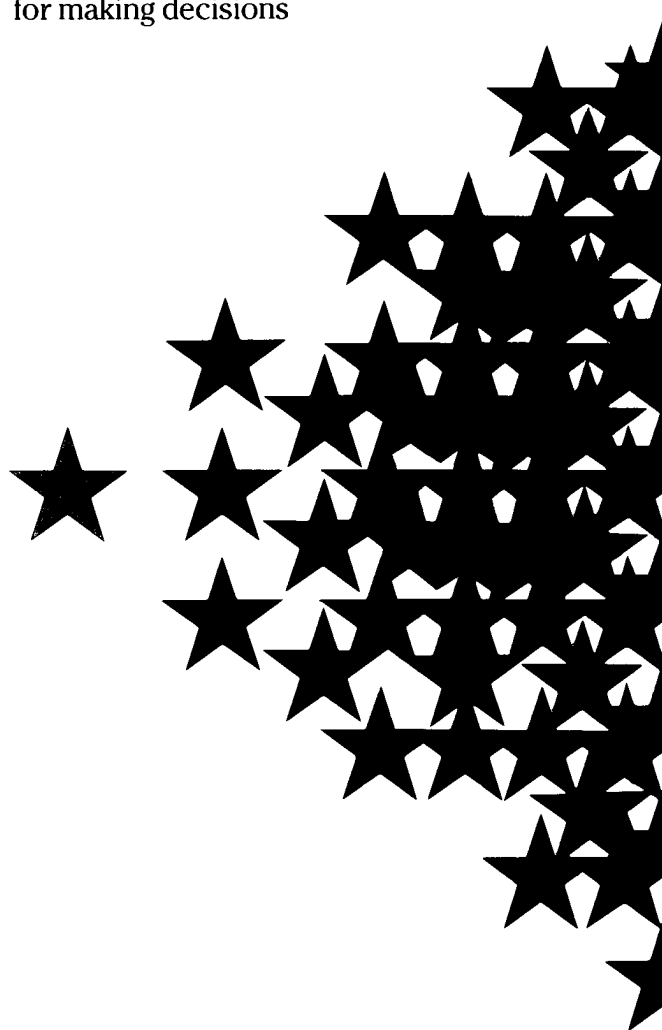




# CRUCIAL QUESTIONS ABOUT TAX REFORM AND YOUR PERSONAL FINANCES

Including a financial profile  
for making decisions



## TAX REFORM IS HERE—WHAT SHOULD YOU DO NOW?

The 1986 Tax Reform Act affects more than your tax planning picture; it will affect the way you and your family save, how you invest, even the way you borrow. Some opportunities will not exist after December 31, 1986, so it's essential that you examine your portfolio and make decisions *now*.

This guide is designed to help you take the first step. The "crucial questions" are intended to provide you with an overview of several major changes in the law, and to emphasize the need to re-evaluate financial planning decisions because of these changes. We have included a financial profile to help you get organized. Then you and your Merrill Lynch Financial Consultant can review your profile and plan your investment strategy, so that you can make the best decisions—while there's still time. We also recommend that you discuss your individual tax situation with your tax advisor.

For a more comprehensive analysis of the Tax Reform Act of 1986 and a discussion of its broad implications, ask your Financial Consultant for a copy of *An Investor's Guide to the 1986 Tax Reform Act*.

### Changes as a result of the 1986 Tax Act

The new tax law introduces two major changes: the change in tax rates and the change in deductibility provisions. Because many deductions will be eliminated or curtailed, some individual taxpayers may pay higher taxes in coming years than they do now, despite lower rates. However, most individual taxpayers will pay less, with the maximum individual rate declining from the current 50% to a maximum of 38½% in 1987 and 28% in 1988 and future years. Beginning in 1988, there will be a 5% surcharge, which will result in a marginal tax rate of 33% for certain individuals.

Most taxpayers will also be affected by other provisions of the new tax law. This guide addresses some commonly asked questions about:

- Changes in the tax treatment of capital gains and losses. (Question 2)
- Changes in the stock market as a result of tax reform. (Question 3)
- Changes in IRAs and other retirement accounts. (Questions 4, 5, and 6)
- Changes in tax-advantaged investments. (Questions 7, 8, 9, 10 and 11)
- Changes in the deductibility of interest expense. (Question 12)

Other provisions of the new tax law may affect your decisions about financial planning, retirement, your children's education and other matters. As you read this guide and complete the profile, keep one crucial point in mind—after December 31, 1986, you may lose the opportunity to make advantageous changes. It's important that you ACT NOW.

## THE TAX REFORM ACT AND YOUR BUSINESS

*The Tax Reform Act also represents a major restructuring of the Federal income tax system for corporations and unincorporated business owners. This creates many opportunities for businesses in the areas of working capital management, equipment finance, retirement planning, tax and investment strategies and business insurance.*

*Businesses, for example, can take maximum advantage of new lower tax rates in 1987 by keeping cash reserves fully invested for better bottom-line returns. Since business interest expense remains fully deductible, business borrowing through lines of credit continues to offer tax advantages.*

*Further, since the new tax law continues to permit earnings within a life insurance contract to grow tax-free, businesses can capitalize on highly attractive yields available in today's tax-advantaged life insurance programs.*

*For an overview of the impact of tax reform on business and suggested strategies to take advantage of these changes, call your Merrill Lynch Financial Consultant for a copy of our special business brochure, The Tax Reform Act of 1986: Financial Strategies for Businesses.*

## QUESTIONS ABOUT TAX REFORM AND YOUR PORTFOLIO

### **1. Should I reposition my portfolio?**

That all depends on what you own now and your goals.

For example, if one of your goals is to defer or shelter as much of your investment income as possible from taxes, then you will probably want to allocate more of your available dollars to holdings that continue to have tax advantages under the new law, such as life insurance, annuities, and tax-exempt municipal bonds.

Or, if you have significant long-term capital gains in your equity portfolio, you may want to consider realizing them in 1986 in light of the change in their tax treatment.

Even if the tax law doesn't affect your portfolio directly, it may have an impact on the performance of your investments. Whatever your investment goals, you will want to consider how changes in the economy and in the financial markets will affect the short- and long-term prospects for your current holdings.

### **2. How will capital gains be taxed in the future? What effect will these changes have on my portfolio?**

Under the new tax law, capital gains will be taxed at the same rate as other income. The current maximum rate for *long-term* capital gains (held at least six months and one day) is 20%. In 1987, long-term capital gains will be taxed at the lesser of your tax bracket or 28%. In 1988 and future years, long-term capital gains are taxed in the same way as any other type of income. If you have unrealized long-term capital gains, and you were planning to take them in the near future, then you should probably take them in 1986.

Of course, you should not decide to sell an asset just because you will pay higher tax on the gain next year. You might not want to sell if you expect the value to continue to increase and if you expect to hold onto the asset indefinitely.

If you have *short-term* capital gains, which are taxed at the same rate as your income, it may be advisable to defer taking them until 1987 when income tax rates will be lower for most individuals.

If you have *long-term* capital losses it may be worthwhile to defer realizing them until 1987 when they will be fully deductible, dollar-for-dollar, against ordinary income. However, *short-term* capital losses are more valuable in 1986, because the deduction, up to \$3,000, offsets income taxed at the current, higher tax rate. Your Merrill Lynch Financial Consultant can discuss which investment strategies are most appropriate for your particular portfolio position.

**3. What changes have occurred in the stock market and how should I react?**

While many economists expect the new tax law to benefit the service sector of the economy and hamper heavy industry, our Securities Research and Economics Division indicates that the tax law's effects are already reflected in the stock prices of companies in the affected segments. Our research analysts are advising clients to allocate a larger portion of their assets to the fixed income sector of the market, rather than to the equity portion, and have identified municipal bonds as a particularly attractive investment opportunity. (See Questions 8 and 9 on municipal bonds.) In a current issue of *Research Insights*, our Securities Research and Economics Division takes an in-depth look at how the tax law will affect the economy, industry and the market. Contact your Financial Consultant for a free copy of the report.

## QUESTIONS ABOUT TAX REFORM AND YOUR RETIREMENT FUNDS

### **4. What should I do about my Individual Retirement Account (IRA)?**

In 1986, IRA contributions are still deductible for all taxpayers and you should contribute to your IRA as soon as possible. Contributions for the 1986 tax year, up to the lesser of \$2,000 or 100% of earned income, may be made until April 15, 1987.

Beginning in tax year 1987, the Tax Reform Act will limit the deductibility of IRA contributions for certain individuals. However, *all individuals may still make voluntary contributions to an IRA, regardless of deductibility status*, subject to a \$2,000 ceiling for individuals and \$2,250 for spousal IRAs.

Thus, although many individuals may lose the benefit of deducting an IRA contribution from their gross income, all the other benefits of an IRA remain. For example, earnings on all IRA contributions will continue to be tax-deferred until the funds are withdrawn. This means an IRA will continue to be an excellent way to prepare for the financial needs of your retirement years.

Specifically, the tax law retains the full \$2,000 deduction (\$2,250 with a spousal account) for all individuals not covered by a qualified retirement, Simplified Employee Pension (SEP) or 403(b) plan. The deduction will also be preserved for single taxpayers covered by such retirement plans, where adjusted gross income is below \$25,000 (\$40,000 for married couples filing joint returns). A partial deduction will be allowed for individuals covered by such a plan and with adjusted gross income between \$25,000 and \$35,000 (\$40,000 to \$50,000 for joint returns). No IRA deduction would be allowed for individuals covered by such a plan and with adjusted gross income above \$35,000 (\$50,000 on joint returns).

**5. How can I maximize the growth of my IRA?**

Three ways to maximize the tax-deferred growth advantages of your IRA:

- make your contributions as early in the year as possible;
- actively manage your accounts; and,
- continue to make your full \$2,000 (or \$2,250 with a spousal account) contribution every year, even if you can deduct only a portion or none of the contribution.

As your funds grow, it becomes more important to manage them in the same effective way that you manage the rest of your portfolio.

**6. How else has the Tax Reform Act affected my retirement funds?**

The favorable ten-year averaging formula for lump-sum distributions will be replaced by a five-year method. For lump-sum distributions occurring after age 59½, recipients will be allowed a one-time election for five-year averaging. Under a transition rule, individuals 50 or older on January 1, 1986, will be permitted to choose either five or ten-year averaging. As before, any lump-sum distribution can retain its tax-deferred status by being rolled over into an IRA instead of using five or ten-year averaging. These changes should increase the appeal of IRA rollovers.

There are new limits on deferrals to certain employer-sponsored retirement plans. Under the new law, annual 401(k) deferrals are limited to \$7,000, while annual 403(b) deferrals are limited to \$9,500. It is a good idea to contribute as much as you can to these plans under the higher 1986 limits (maximum \$30,000). You may also want to consider putting the difference between your customary contribution and the new lower limit into another tax-advantaged vehicle, such as a single premium life insurance policy or a tax-deferred annuity.

## QUESTIONS ABOUT TAX REFORM AND TAX MINIMIZATION

### 7. Is tax minimization still an important goal?

Even though tax rates will be lower, saving on taxes will remain an important consideration for most people. Certainly, with a new top tax rate of 38½% in 1987 and 28% in 1988, the return on taxable investments does not need to be as high to make them attractive relative to tax-free investments. But particularly when saving for long-term goals, such as your children's college education and your retirement, the benefits of tax-deferred and tax-free investments can be considerable.

### How Your Money Can Grow Faster in a Tax-Deferred Account

The example below is based on a \$25,000 investment earning 8%\* interest over a 25 year period. Column I shows the value of the investment when the interest earnings are taxed annually, before compounding, at a 28% tax rate. Column II shows the pre-tax value of the same investment earning interest at a tax-deferred rate.

	I	II
End of Year	Value of Investment After Taxes	Value of Investment Compounded Tax-Deferred
5	\$33,079	\$ 36,733
10	43,768	53,973
15	57,911	79,304
20	76,625	116,524
25	101,386	171,212

\*The 8% rate is for illustrative purposes only and is not meant to be a representation of today's interest rates.



**8. Are municipal bonds still tax free?**

Yes and no.

All municipal bonds (including private purpose) *issued* prior to 8/8/86 will remain Federally tax exempt.

Due to the new tax law, municipal bonds issued after 8/7/86 are now segregated into three categories:

- Public purpose municipals (i.e. water and sewage projects, school bonds, public power agencies)—interest totally free from Federal income taxation.
- Tax-exempt private purpose municipals (i.e. student loan bonds and some industrial development bonds)—interest subject to an alternative minimum tax of 21% for *some* individuals.
- Taxable private use municipals (i.e. single-family housing, sports stadiums, pollution control revenue bonds)—interest is fully taxable on the Federal level.

**9. Are all three types of municipal bonds still good investments?**

As this brochure goes to press, public purpose bonds and tax-exempt private purpose municipal bonds issued prior to 8/8/86 are among the best investments available, since some of these long-term bonds are actually yielding more than long-term Treasury bonds. Further, because of certain provisions in the tax law, it is expected that the new issue supply of tax-free municipals will diminish. This, combined with expected strong demand from insurance companies, individuals, mutual funds, and trusts could tend to lower interest rates on tax-free municipals. Therefore, there is potential for price appreciation in certain municipals bought at current prices.

The current markets for taxable municipal bonds and municipal bonds subject to the alternative minimum tax have not fully developed. As more of these types of bonds become available in the markets, they may be suitable investments for some individuals.

Investors should also keep in mind that although Federal income taxes may be lower, state and local income taxes will remain high in many states. Investors in high tax states may find considerable advantage to investing in municipal bonds issued by your state and local governments. Your Merrill Lynch Financial Consultant can provide you with more information about tax-advantaged bonds and availability for your locality.

**The Tax-Exempt Edge of Municipal Bonds Based on Income Tax Brackets**

Using the Taxable Equivalency chart, you can measure what taxable yields you would have to receive to equal the yield of a tax-free municipal bond.

If the yields available on taxable securities are lower than those on the chart, it would be advantageous for you to purchase tax-free municipal bonds. This chart only considers Federal taxes. Some states also exempt the interest on municipals from state and local income taxation as well.

### **Taxable Equivalency Chart**

To see what a taxable security would have to yield to equal the yield of a tax-free security find your taxable income and read across. For example, if you are in the 28% Federal tax bracket, you would have to earn 9.72% from a taxable bond to match the take-home yield you could get from a tax-exempt municipal paying 7%.

#### **Based on 1987 Income Tax Brackets**

Federal tax bracket	Tax-exempt yield of:			
	6½%	7%	7½%	8%
Equivalent Taxable Yield				
11%	7.30	7.86	8.42	8.98
15%	7.64	8.23	8.82	9.41
28%	9.02	9.72	10.41	11.11
35%	10.00	10.76	11.53	12.30
38½%	10.56	11.38	12.19	13.00

#### **Based on 1988 Income Tax Brackets**

Federal tax bracket	Tax-exempt yield of:			
	6½%	7%	7½%	8%
Equivalent Taxable Yield				
15%	7.64	8.23	8.82	9.41
28%	9.02	9.72	10.41	11.11
33%*	9.70	10.45	11.19	11.94

\*If the 5% surcharge applies

**10. Are there other ways to defer income so that I can save for retirement and my long-term goals?**  
Yes. There are two other products whose tax-advantages remain intact under the new laws, offering ways to insulate against current income taxation.

Both annuities, which permit income to grow on a tax-deferred basis, and single premium life insurance, in which assets grow tax-free, can be useful ways of saving for retirement and other long-term goals.

Similar to the tax treatment of retirement plans, annuities enable you to defer taxes on earnings on your contributions until distribution. In this way you can earn income on your original contribution, on the accumulated earnings and on amounts that would otherwise be paid in taxes.

In a life insurance plan, the increase in cash value is not subject to current income tax. Also when the death benefits are paid on the policy, they will be received income tax-free. Another important benefit of life insurance policies is that you can borrow against the cash value at no or low net cost income tax-free, while the policy is in force. In this way you can access a portion of the cash value for long-term goals.

**11. Has the new law affected any accounts I have for my child? What should I do about it?**

Yes, the new law has affected UGMAs/UTMAs, Clifford and temporary (i.e. spousal remainder) trusts. Under new UGMA/UTMA restrictions, investment income in excess of \$1,000 that has been earned on all gifts to a child will be taxed at the parent's rate if the child is under 14 at the end of the calendar year. This change will occur regardless of the date of the transfer.

With regard to Clifford or other temporary trusts, investment income in excess of \$1,000 earned on pre-March 1, 1986 gifts to a child will be taxed at the parent's rate if the child is under 14 at the end of the calendar year. Investment income earned on all other transfers made on or after March 1, 1986, will be taxed to the grantor.

To avoid taxation at the parent's rate, in most states you can put UGMA/UTMA or pre-March 1, 1986 trust assets in one or more of three vehicles:

- tax-exempt securities
- low or no income high growth securities
- insurance products that provide for tax-free growth, such as single premium life insurance.

## QUESTIONS ABOUT TAX REFORM AND CREDIT

### 12. How will the new tax law affect my credit decisions?

The new tax law makes it even more important for you to reduce your credit costs. With the new tax law, the interest on your consumer debt *will lose its deductibility*. If you're in the 50% bracket the 18% you pay on revolving credit cards won't be 9% after-tax any longer.

Consumer interest deductions will be phased out over 5 years, beginning in 1987. So after the transition period, if you're paying 18%, you're really paying 18% as shown in the table below.

Interest Expense After New Tax Law*				
	Credit Card	Auto Loan	Equity Access™ Account	Margin Account
Pre-tax Interest Expense	18%	11%	9.5%	7.75%
After-tax Interest Expense (28% bracket)	18%**	11%**	6.8%	5.6%

\*Equity Access™ accounts are available in most states. Rates are as of 9/10/86 and may vary. After-tax Margin and Equity Access rates are for qualifying interest expenses. Margin rates are based on balances over \$50,000.

\*\*After the transition period, such consumer interest is no longer deductible.

### Some types of interest expense will still be deductible

#### • Home Mortgage Interest

An important source of tax deductible credit will be home mortgages, including home equity credit lines on both your first and second homes. You may continue to deduct interest expense on an amount equal to the purchase price plus the cost of improvements.

You may also deduct interest on a larger amount up to the fair market value of your home if the funds are used for education or medical expenses.

With the Merrill Lynch Equity Access™ account you can borrow at a lower interest rate than most consumer loans, and you can deduct qualifying interest expense from your taxes, which lowers the effective interest rate even more.

- **Investment Interest**

Another way to borrow and deduct the expense is to use a Margin account for your investments. Under the new tax law, you may continue to deduct interest expense incurred for investment purposes against net investment income.

With a consolidated asset account, such as the Merrill Lynch Cash Management Account® financial service, it's easy to monitor investment income and expense, and take full advantage of the allowable deduction. By borrowing on margin to meet your investment needs, you can free up cash for large purchases, thereby avoiding non-deductible consumer credit costs.

While there is a certain level of risk to borrowing on margin, this can be minimized by limiting the amount borrowed against your securities and by borrowing against a portfolio of relatively stable securities. Your Financial Consultant can provide more information.

### **13. What should I do now?**

Since a short time remains until tax reform takes effect, you need to *act quickly*. Start by completing the attached profile. This information-gathering tool will help you get organized and will serve as the basis for your conversation with your Merrill Lynch Financial Consultant. This information will help your Financial Consultant evaluate specific services and their appropriateness to your individual situation.

Your Financial Consultant can introduce you to other more extensive financial planning services that are available through Merrill Lynch as well. So call your Financial Consultant or your local Merrill Lynch office today.

YOUR FINANCIAL PROFILE

This profile is designed to help you organize some pertinent information and analyze your financial situation. Refer back to this brochure to make some preliminary determinations on your own.

You may wish to discuss your specific situation with your tax advisor, to determine the potential change in your income tax liability. This profile is not intended to analyze your income tax liability.

As part of your overall financial and tax planning, you may wish to discuss your future investment goals with your Financial Consultant to develop some immediate solutions and longer-term investment strategies.

Mr.  
Mrs.  
Ms.

First Name Middle Initial Last Name

Street

City State Zip  
Daytime Phone: ( )

What are your major investment goals? (Please number in order of importance, e.g. #1 = most important.)

\_\_\_\_\_ college education for children

\_\_\_\_\_ current income

\_\_\_\_\_ retirement income

\_\_\_\_\_ tax minimization

\_\_\_\_\_ purchase of a home

\_\_\_\_\_ estate transfers

\_\_\_\_\_ other (list)

What is your age? \_\_\_\_\_

What is your family status?

\_\_\_\_\_ single

\_\_\_\_\_ married

\_\_\_\_\_ widowed

\_\_\_\_\_ children

Ages of children: \_\_\_\_\_

What is your total family taxable income range?

- ☐ \$35,000-\$50,000
- ☐ \$50,000-\$75,000
- ☐ \$75,000-\$150,000
- ☐ \$150,000 plus

TAX REFORM AND YOUR PORTFOLIO/TAX  
MINIMIZATION

Current value of holdings (excluding funds in tax-  
deferred retirement accounts).

\$ \_\_\_\_\_ Stocks and equity mutual funds

\$ \_\_\_\_\_ Cash and cash equivalents (check-  
ing accounts, savings accounts,  
money market mutual funds)

\$ \_\_\_\_\_ Fixed income instruments (CDs,  
bonds, bond funds)

\$ \_\_\_\_\_ taxable  
instruments

\$ \_\_\_\_\_ non-taxable  
instruments

\$ \_\_\_\_\_ Annuities

\$ \_\_\_\_\_ Cash value of life insurance

\$ \_\_\_\_\_ Tax oriented limited partnerships

\$ \_\_\_\_\_ Options/Futures

\$ \_\_\_\_\_ Real estate other than your home

Do you have any custodial and/or trust accounts?

- ☐ UGMA
- ☐ UTMA
- ☐ Clifford Trust/Other



TAX REFORM AND YOUR RETIREMENT FUNDS

Current value of holdings in tax-deferred accounts

\$ \_\_\_\_\_ IRA(s)

\$ \_\_\_\_\_ Rollover IRA(s)

\$ \_\_\_\_\_ Keogh or Basic™ account

\$ \_\_\_\_\_ SEP

\$ \_\_\_\_\_ Company or Corporate pension  
funds (vested portion)

Do you plan to retire within the next five years? \_\_\_\_\_

TAX REFORM AND CREDIT

Under the new tax law, your residence(s) may become an  
important source of credit.

	Primary Residence	Secondary Residence
Purchase price	\$ _____	\$ _____
Capital improvements	\$ _____	\$ _____

Please list all outstanding debt:

	Balance	Interest Rate
First mortgage for primary residence	\$ _____	% _____
First mortgage for secondary residence	_____	_____
Bank loans	_____	_____
Loans on insurance policies	_____	_____
Auto loans	_____	_____
Credit card debt	_____	_____
Other revolving credit debt	_____	_____
Student loans	_____	_____
Margin accounts	_____	_____
Second mortgage(s)	_____	_____
Other debt (list)	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

**TAX REFORM AND BUSINESS**

Do you own or control a business? \_\_\_\_\_

How is it structured?

- ☐ Sole Proprietorship      ☐ S Corporation  
☐ Partnership              ☐ Regular Corporation

Do you need tax reform recommendations in any of the following:

- ☐ Working capital management  
☐ Equipment financing  
☐ Investment strategies  
☐ Business insurance

**OTHER**

What charitable commitments have you made for 1987?

\_\_\_\_\_  
\_\_\_\_\_

Do you have specific questions about any other areas of tax reform? \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

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